SCS Agency
Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Bill Number: AB 1937

Related Bills: See Legislative History
Telephone: 845-3410
Introduced Date: 02/17/98

Attorney: Doug Bramhall
Sponsor:

SUBJECT: Additional Enterprise Zone

SUMMARY

Under the Government Code, this bill would require the Trade and Commerce Agency (TCA) to designate an additional enterprise zone. This bill would specify that TCA could designate only an area that meets certain additional criteria.

This bill would provide that all tax incentives provided to existing enterprise zones under the Revenue and Taxation Code would apply to the enterprise zone designated under this bill.

EFFECTIVE DATE

This bill would be operative on January 1, 1999.

LEGISLATIVE HISTORY

AB 69, AB 82, AB 797 (Stats. 1997, Ch. 461), AB 1217 (Stats. 1997, Ch. 602), SB 200 (Stats. 1997, Ch. 609), SB 635, SB 965 (Stats. 1997, Ch. 603); AB 2456 (1996), AB 296 (Stats. 1996, Ch. 953), SB 715 (Stats. 1996, Ch. 952), SB 2023 (Stats. 1996, Ch. 955); SB 712 (Stats. 1995, Ch. 494); AB 2206 (Stats. 1994, Ch. 853), SB 1438 (Stats. 1994, Ch. 754), SB 1770 (Stats. 1994, Ch. 755).

PROGRAM HISTORY/BACKGROUND

California has five types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Los Angeles Revitalization Zone (LARZ),
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Area (MEA).

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Board Position:	Agency Secretary Position:	GOVERNOR'S OFFICE USE
____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR ____X____ PENDING	____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO ____________	Position Approved ____ Position Disapproved ____ Position Noted ____
Department Director Gerald H. Goldberg 3/9/98	Agency Secretary Date	By: Date:

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LARZ*	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	X	
Hiring Credit	X	X	X	X	X
Construction Hiring Credit		X			
Employee Wage Credit	X				
Business Expense Deduction	X	X	X	X	
Net Interest Deduction	X	X			
Net Operating Loss	X	X	X	X	

* NOTE: the LARZ expires December 1, 1998.

Under the Government Code, the prior Program Area Act provided for the designation by TCA of nine program areas. In 1996, these areas were converted to enterprise zones. In preparation for designating program areas, TCA was required to identify all "high density unemployment areas" in a statewide map according to county. To be identified as a high density unemployment area, the area had to meet the following criteria:

1. Be a metropolitan statistical area containing at least 4,000 people or a nonmetropolitan statistical area containing at least 2,500 people.

2. An average unemployment rate for the prior 12-month period of at least one and one half times the average national rate.

3. An average poverty rate for the prior 12-month period of at least one and one half times the average national rate.

4. At least 70% of the household earnings in the area was a maximum of 80% of the statewide average.

SPECIFIC FINDINGS

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an enterprise zone. Using specified criteria, TCA designates enterprise zones from the applications received from the governing bodies. Enterprise zones are designated for 15 years, and TCA has designated the 39 enterprise zones authorized under existing law.

Under the Government Code, existing state law provides for the designation of the Los Angeles Revitalization Zone. Using specified criteria, the TCA designated the LARZ from the maps received from the governing bodies of Los Angeles County and surrounding cities that suffered from civil disturbances in April and May 1992.

The geographic areas that qualified and were designated as the LARZ were Compton, Hawthorne, Huntington Park, Inglewood, Lawndale, Long Beach, portions of Los Angeles, Lynwood, Pomona, Signal Hill, portions of unincorporated Los Angeles County.

The Trade and Commerce Agency (TCA) determines whether an approved map complies with, and remains in compliance with, these criteria. Any map determined to be out of compliance is void. The LARZ was designated in 1992 and is binding for five years.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within enterprise zones or the LARZ. These incentives include a sales or use tax credit, hiring credit, LARZ construction hiring credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within the economic development areas and a tax credit for employees working in an enterprise zone. See Attachment A for a detailed discussion of each tax incentive.

AB 1937 would require the TCA to designate an additional enterprise zone. To qualify for designation as an enterprise zone under this bill, an area must meet each of the criteria listed below:

1. An unemployment rate that is at least three times the national average for the preceding five years.

2. A median household income of less than 80% of the statewide average.

3. A poverty rate that is at least twice the national average.

4. A steady decline in the number of new business enterprises over the past three years.

5. Designated as a "high density unemployment area" under the prior Program Area Act.

6. Be located in a specified geographic area in Los Angeles County surrounding Inglewood.

This bill would specify that all tax incentives provided to existing enterprise zones under the Revenue and Taxation Code would apply to the new enterprise zone designated under this bill.

Policy Consideration

This bill does not specify the duration of the enterprise zone designation that would be provided under this bill.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

The revenue loss from this bill is estimated as follows:

Effective After December 31, 1997 Assumed Enactment After June 30, 1998 (In Millions)		
1998-9	1999-0	2000-1
Negl. Loss *	Minor Loss **	($1)

* Less than $250,000
** Less than $500,000

Tax Revenue Discussion

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue losses under the Personal Income Tax Law and the Bank and Corporation Tax Law would depend on the number of businesses that would purchase qualified property subject to the sales tax, the amount of wages paid to qualifying employees, and the state tax liabilities of employers claiming tax benefits.

Because the effectiveness of a new zone is unknown and the potential exists for significant businesses to locate in a zone, the average revenue loss of $1 million per zone per year has been used (for the 1995 tax year, the total revenue loss for the 37 enterprise zones that existed in that year was $37 million). However, the cumulative loss for the first two years is expected to be less than $500,000.

BOARD POSITION

Pending.

ASSEMBLY BILL 1937 (MURRAY)
INTRODUCED FEBRUARY 17, 1998
Attachment A

ENTERPRISE ZONE AND LARZ TAX INCENTIVES

Sales or Use Tax Credit

The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in the enterprise zone or LARZ. The amount of the credit is limited to the tax attributable to enterprise zone or LARZ income. Qualified property is defined as follows:

Enterprise Zone:
- machinery and machinery parts used to:
  - manufacture, process, combine, or otherwise fabricate a product;
  - produce renewable energy resources; or
  - control air or water pollution.

LARZ:
- building materials used to replace or repair the business's building and fixtures; and
- machinery or equipment, excluding inventory.

In addition, qualified property must be purchased and placed in service before the enterprise zone or LARZ designation expires. The maximum value of property that may be eligible for the enterprise zone sales or use tax credit is $1 million for individuals and $20 million for corporations. This limitation does not exist for the LARZ sales or use tax credit.

Hiring Credit

A business located in an enterprise zone or LARZ may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an enterprise zone or LARZ and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the enterprise zone or LARZ and at least 50% must be performed inside the enterprise zone or LARZ. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on enterprise zone or LARZ income. The total amount of the credit is the sum of each the following:

- 50% of the wages paid in the first year of employment;
- 40% of the wages paid in the second year of employment;
- 30% of the wages paid in the third year of employment;
- 20% of the wages paid in the fourth year of employment;
- 10% of the wages paid in the fifth year of employment.

The credit generally is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (for certain Long Beach Enterprise Zone employees, the maximum is 202% of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit. Certain criteria regarding who may be qualified employees and certain limitations differ between the various enterprise zone or LARZ.

LARZ Construction Hiring Credit

A business located in a LARZ may reduce tax by a percentage of wages paid to construction employees. A qualified construction employee must be hired on or after May 1, 1992, be a resident of the LARZ, and be hired by the employer to perform construction work in the LARZ. Construction work is any work directly related to the demolition, repair, erection, or renovation of a structure located within the LARZ. The business may claim 50% to 100% of the wages paid to a qualified employee as a credit against tax imposed on LARZ income. The actual percentage depends upon the date the employee was hired:

Date Hired	Applicable %
5/1/92 - 6/30/93	100%
7/1/93 - 12/31/93	75%
1/1/94 - 12/31/97	50%
After 12/31/97	0%

As is the hiring credit, the construction hiring credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. Also, the amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring construction credit.

Business Expense Deduction

A business located in an enterprise zone or LARZ may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the enterprise zone or LARZ. The deduction is allowed in the taxable or income year in which the taxpayer places the qualified property in service. The property's basis must be reduced by the amount of the deduction. For enterprise zones, the maximum deduction for all qualified property is the lesser of 40% of the cost, or the following:

If the property was placed in service:

Months after designation	Maximum deduction Enterprise Zones
0 to 24	$40,000
25 to 48	30,000
48 and over	20,000

This limitation does not apply to the LARZ.

Net Operating Loss Deduction

A business located in an enterprise zone or LARZ may elect to carry over 100% of the enterprise zone or LARZ net operating losses (NOLs) to deduct from enterprise zone or LARZ income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the enterprise zone or LARZ.

Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone or a LARZ. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone or LARZ and the lender may not have equity or other ownership interest in the enterprise zone or LARZ trade or business.

Enterprise Zone Employee Wage Credit

Certain disadvantaged individuals are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5% of “qualified wages,” defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone, computed as though that income represented the taxpayer’s entire taxable income. This incentive is not available for LARZ.

Apportioning

For businesses operating inside and outside an enterprise zone or LARZ, the amount of credit or net operating loss deduction that may be claimed is limited by the amount of tax or income attributable to the enterprise zone or LARZ. For businesses operating in the LARZ, these amounts are determined using a formula based on the property and payroll of the business. For businesses operating in an enterprise zone the apportionment formula is the same as that used by all businesses that operate inside and outside the state, which, along with property and payroll, includes a double-weighted sales factor.